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December 20, 2001



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VIA HAND DELIVERY

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

E-01773A-01-0701

Re: *Compliance Item on Decision No. 64227*
AEPCO Gas Turbine 4 Financing
CFC Loan Documents

Dear Sir/Madam:

Pursuant to the eighth ordering paragraph at page 4 of Decision No. 64227, enclosed are executed loan documents from the National Rural Utilities Cooperative Finance Corporation ("CFC") pertaining to AEPCO's interim financing on the above-entitled matter. Although Schedule 1 reflects a CFC commitment of \$24.5 million, CFC has been advised of the Commission authorization of \$23.7 million in interim financing. Advances only up to the \$23.7 million interim amount authorized in Decision 64227 will be requested by AEPCO and made by CFC.

Very truly yours,

GALLAGHER & KENNEDY, P.A.

Michael M. Grant

By:

Michael M. Grant

Original and ten (10) copies
filed with Docket Control.

Linda Maguire
cc: Pat Williams, ACC Utilities Division
Gary Pierson, AEPCO

MMG/lmm
10421-0027/982639

Arizona Corporation Commission
DOCKETED
DEC 20 2001



J. Pierson



NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
Powerful Financial Solutions

2201 Cooperative Way · Herndon, Virginia 20171-3025
<http://www.nrucfc.org>
703-709-6700



December 13, 2001

Mr. Dirk C. Minson
Chief Financial Officer
Arizona Electric Power Cooperative, Inc.
1000 South Highway 80
Benson, Arizona 85602

Re: Loan Designation AZ 028-A-9028

Dear Mr. Minson:

Your cooperative has executed and returned all required CFC loan documents and supporting papers in connection with the loan designated above. These documents have been reviewed and found legally acceptable and satisfactory to CFC and thus constitute binding agreements between CFC and your system.

Loan funds may now be requisitioned in accordance with the terms of the Loan Agreement.

We at CFC appreciate the opportunity to be of service to you and look forward to our continued business relationship.

Sincerely,

David Farrell
Associate Vice President

DF/km

cc: Pat Cooper, Esquire
Alfred Rodgers, RUS



LOAN AGREEMENT

LOAN AGREEMENT, (this "Agreement") dated December 12, 2001 between ARIZONA ELECTRIC POWER COOPERATIVE, INC. (herein called the "Borrower"), a cooperative corporation organized and existing under the laws of the State of Arizona and NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION (herein called "CFC"), a cooperative association incorporated and existing under the laws of the District of Columbia.

RECITALS

WHEREAS, the Borrower has applied to CFC for a loan and agrees to use the proceeds thereof for Project expenses only, consistent with the Borrower's articles of incorporation, bylaws and applicable federal, state and local laws and regulations; and

WHEREAS, CFC has approved a loan to the Borrower in the aggregate principal amount of the CFC Commitment, subject to the terms and conditions stated herein; and

WHEREAS, the Borrower has agreed to execute a promissory note to evidence Borrower's indebtedness to CFC under this Agreement;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants hereinafter contained, the parties hereto agree and bind themselves as follows:

ARTICLE I

DEFINITIONS

"Advance" or "Advances" shall mean one or more advances of funds by CFC to Borrower under the Note and pursuant to the terms and conditions of this Agreement.

"Business Day" shall mean any day that both CFC and the depository it utilizes for funds transfers hereunder are open for business.

"CFC Commitment" shall have the meaning as defined in Schedule 1 hereto.

"CFC Fixed Rate" shall mean the fixed rate as available for loans similarly classified pursuant to CFC's policies and procedures in effect from time to time.

"CFC Fixed Rate Term" shall mean the specific period of time that a CFC Fixed Rate is in effect.

"CFC Variable Rate" shall mean the rate established by CFC for variable interest rate loans similarly classified pursuant to CFC's policies and procedures in effect from time to time.

"Conversion Request" shall mean a written request from any duly authorized official of the Borrower, in form and substance satisfactory to CFC, that requests an interest rate conversion.

"Debt Service Coverage Ratio ("DSC")" shall mean the ratio determined as follows: for any calendar year add (i) Operating Margins, (ii) Non-Operating Margins--Interest, (iii) Interest Expense, (iv) Depreciation and Amortization Expense for such year, and (v) cash received in respect of generation and transmission and other capital credits, and divide the sum so obtained by the sum of all payments of principal and interest during such calendar year; *provided, however*, that in the event that any long-term Debt has been refinanced during such year the payments of Principal and Interest Expense required to be made during such year on account of such long-term Debt shall be based (in lieu of actual payments required to be made on such refinanced long-term Debt) upon the larger of (i) an annualization of the payments required to be made with respect to the refinancing debt during the portion of such year such refinancing debt is outstanding or (ii) the payment of Principal and Interest Expense required to be made during the following year on account of such refinancing debt.

"Depreciation and Amortization Expense" shall mean an amount constituting the depreciation and amortization of the Borrower as computed for purposes of Form 12.

"Distribution" shall have the meaning defined in 5H.

"Equity" shall mean the aggregate of Borrower's equities and margins as computed pursuant to generally accepted accounting principles.

"Final Maturity Date", shall mean the date that is twenty (20) years from the date of the initial Advance on the Note, *provided, however*, that if such date is not a Payment Date, then the Final Maturity Date shall be the Payment Date immediately preceding such date.

"Form 12" shall mean the RUS Form 12, and any successor form(s), as the same may be amended from time to time.

"Initial Maturity Date", shall mean the date that is four (4) years from the date of the initial Advance on the Note, *provided, however*, that if such date is not a Payment Date, then the Initial Maturity Date shall be the Payment Date immediately preceding such date.

"Interest Expense" shall mean an amount constituting the interest expense with respect to Total Long-Term Debt of the Borrower as computed for purposes of Form 12. In computing Interest Expense, there shall be added, to the extent not otherwise included, an amount equal to 33-1/3% of the excess of Restricted Rentals paid by the Borrower over 2% of the Borrower's Equity.

"LCTC" shall mean the Loan Capital Term Certificate as described in Section 5.D. hereto.

"Non-Operating Margins--Interest" shall mean the amount of non-operating margins-interest of Borrower as computed for purposes of Form 12.

"Note" shall mean the promissory note executed by Borrower pursuant to this Agreement.

"Patronage Capital and Operating Margins" shall mean the net amount of operating revenue and patronage capital less the total cost of electric service of the Borrower as computed for purposes of Form 12.

"Paying Agent Service" shall mean the service offered by CFC whereby CFC, as agent for the Borrower, undertakes to make debt service and other payments on behalf of and as directed by the Borrower.

"Payment Date" shall mean the last day of each of the months referred to in Schedule 1 hereto.

"Payment Notice" shall mean a notice furnished by CFC to Borrower that indicates the precise amount of each payment of principal and interest and the total amount of each payment.

"Principal" shall mean the amount of principal billed on account of Total Long-Term Debt of Borrower as computed for purposes of Form 12.

"Project" shall mean the combustion turbine generating project described on Schedule 1 hereto.

"Restricted Rentals" shall mean all rentals required to be paid under finance leases and charged to income, exclusive of any amount paid under any such lease (whether or note designated herein as rental or additional rental)(for maintenance or repairs, insurance, taxes, assessments, water rates or similar charges. For the purpose of this definition the term "finance lease" shall mean any lease having a rental term (including the term for which such lease may be renewed or extended at the option of the lessee) in excess of three (3) years and covering property having an initial cost in excess of \$250,000 other than automobiles, trucks, trailers, other vehicles (including without limitation aircraft and ships), office, garage and warehouse space and office equipment (including without limitation computers).

"RUS" shall mean the Rural Utilities Service of the United States of America, Department of Agriculture and any successor governmental agency.

"RUS Loans" shall mean loans made by RUS to the Borrower, or made to the Borrower by a third party and guaranteed as to payment by RUS, in each instance for such purposes as are authorized in the Rural Electrification Act of 1936, as amended (7 U.S.C. § 901 et seq.).

"Total Assets" shall mean an amount constituting the total assets of the Borrower as computed for purposes of Form 12.

"Total Long-Term Debt" shall mean an amount constituting the long-term debt of the Borrower as computed for purposes of Form 12.

"Total Utility Plant" shall mean the amount constituting the total utility plant of the Borrower as computed for purposes of Form 12.

ARTICLE II

REPRESENTATIONS AND WARRANTIES

Section 2.1. The Borrower represents and warrants that:

A. Good Standing. The Borrower is a cooperative corporation duly incorporated, validly existing and in good standing under the laws of the state of its incorporation, is duly qualified in those states in which it is required to be qualified to conduct its business and has corporate power to enter into and perform this Agreement and to borrow hereunder. The Borrower is a member in good standing of CFC.

B. Authority. The execution, delivery and performance by the Borrower of this Agreement and the Note and the performance of the transactions contemplated thereby have been duly authorized by all necessary corporate action and will not violate any provision of law or of the Articles of Incorporation or bylaws of the Borrower or result in a breach of, or constitute a default under, any agreement, indenture or other instrument to which the Borrower is a party or by which it may be bound. The Borrower is not in default of any of its obligations to the RUS.

C. Litigation. There are no suits or proceedings pending or to the knowledge of the Borrower threatened against or affecting the Borrower or its properties which, if adversely determined, would have a material adverse effect upon the financial condition or the business of the Borrower. The Borrower is not, to its knowledge, in default with respect to any judgment, order, rule or regulation of any court, governmental agency or other instrumentality which would have a material adverse effect on the Borrower.

D. Financial Statements. The balance sheet of the Borrower as at the date identified in Schedule 1 hereto, and the statement of operations of the Borrower for the period ending on said date, heretofore furnished to CFC, are complete and correct. Said balance sheet fairly presents the financial condition of the Borrower as at said date and said statement of operations fairly reflects its operations for the period ending on said date. The Borrower has no contingent obligation or unusual forward or long-term commitments except as specifically stated in said balance sheet or herein. There has been no material adverse change in the financial condition or operations of the Borrower from that set forth in said financial statements except changes disclosed in writing to CFC prior to the date hereof. The Borrower has heretofore furnished to CFC true and complete copies of its financial and statistical reports to the RUS on Form 12 for each of the three most recent calendar years, and a copy of its most recent such report on Form 12 and the facts stated therein are true as of the date hereof.

E. Location of Office. The principal place of business of the Borrower and the office where its records concerning accounts and contract rights are kept is identified in Schedule 1 hereto.

F. Required Approvals. No license, consent or approval of any governmental agency or authority is required to enable the Borrower to enter into this Agreement or the Note or to perform any of its obligations provided for except that of the RUS, and except as disclosed in Schedule 1 hereto, in such documents all of which Borrower has obtained prior to the date hereof.

G. Survival. All representations and warranties made by the Borrower herein or made in any certificate delivered pursuant hereto shall survive the making of the Advances and the execution and delivery to CFC of the Note.

ARTICLE III

LOAN

Section 3.1. Advances. CFC agrees to make, and the Borrower agrees to request, on the terms and conditions of this Agreement, Advances from time to time at the main office of CFC, or at such other place as may be mutually agreed upon, in an aggregate principal amount not to exceed the CFC Commitment, *provided, however*, that CFC shall have no obligation to make any Advance on or after the Initial Maturity Date. The Borrower shall give CFC at least one (1) day's written notice of the date on which each Advance is to be made.

Section 3.2. Interest Rate and Payment. The Note shall be payable and bear interest as follows:

A. Payments; Maturity; Amortization.

(a) Advances shall not amortize and shall be repaid on the earlier of (i) the Payment Date corresponding to the term of the Advance and (ii) the Initial Maturity Date, at which time all unpaid principal, interest accrued thereon and fees, if any, shall be due and payable. If the loan has been converted to an amortizing loan pursuant to Section 3.5 hereof, then all Advances shall be repaid on the Final Maturity Date, upon which date all unpaid principal, interest accrued thereon and fees, if any, shall be due and payable. If the term of an Advance ends on a date that is not a Payment Date, or if the Initial Maturity Date or Final Maturity Date is not a Payment Date, then the repayment of such Advance shall be due and payable on the Payment Date immediately preceding such date.

(b) CFC will furnish to the Borrower a Payment Notice at least ten (10) days before each Payment Date, provided, however, that CFC's failure to send a Payment Notice shall not constitute a waiver by CFC or be deemed to relieve Borrower of its obligation to make payments as and when due as provided for herein.

(c) No provision of this Agreement or of any Note shall require the payment, or permit the collection, of interest in excess of the highest rate permitted by applicable law.

B. Application of Payments. Each payment shall be applied first to any charges other than interest or principal then due on the Note, second to interest accrued on the principal amount of the Note, and the balance to principal on the Note.

C. Election of Interest Rate and Interest Rate Computation. Prior to each Advance on a Note, the Borrower must select in writing either a CFC Fixed Rate or the CFC Variable Rate, as follows:

(a) CFC Fixed Rate. If the Borrower elects a CFC Fixed Rate for an Advance, then such rate shall be in effect for the CFC Fixed Rate Term selected by Borrower. CFC shall provide the Borrower with at least thirty (30) days prior written notice of the date on which a CFC Fixed Rate is due to reprice. Pursuant to CFC's policies of general application for repricing, the Borrower may choose any of the interest rate options then available for similarly classified loans repricing from a CFC Fixed Rate. If Borrower does not select an interest rate in writing when a CFC Fixed Rate is

subject to repricing, then outstanding Advances shall reprice for the same CFC Fixed Rate Term as in effect immediately prior to the repricing, and shall bear interest at the then prevailing CFC Fixed Rate in effect for such term. For any Advance, the Borrower may not select a CFC Fixed Rate with a CFC Fixed Rate Term that extends beyond the Initial Maturity Date, provided, however, that if the loan has been converted to an amortizing loan pursuant to Section 3.5 hereof, then the Borrower may select a CFC Fixed Rate with a CFC Fixed Rate Term that extends up to the Final Maturity Date. Interest on amortizing Advances bearing interest at a CFC Fixed Rate shall be computed for the actual number of days elapsed on the basis of a year of 365 days, until the first day of the complete calendar quarter following the date that the Advances begins to amortize. Thereafter, interest shall be computed on the basis of a 30-day month and 360-day year. Interest on non-amortizing Advances bearing interest at a CFC Fixed Rate shall be computed for the actual number of days elapsed on the basis of a year of 365 days.

(b) CFC Variable Rate. If the Borrower elects the CFC Variable Rate for an Advance, then such CFC Variable Rate shall apply until the Advance is repaid, unless the Borrower elects to convert to a CFC Fixed Rate pursuant to the terms hereof. Interest on Advances bearing interest at the CFC Variable Rate shall be computed for the actual number of days elapsed on the basis of a year of 365 days.

Section 3.3. Conversion of Interest Rates.

A. CFC Variable Rate to a CFC Fixed Rate. The Borrower may at any time convert from the CFC Variable Rate to a CFC Fixed Rate by submitting to CFC a Conversion Request requesting that a CFC Fixed Rate apply to any outstanding Advance. The rate shall be equal to the rate of interest offered by CFC in effect on the date of the Conversion Request. The effective date of the new interest rate shall be a date determined by CFC pursuant to its policies of general application following receipt of the Conversion Request.

B. CFC Fixed Rate to CFC Variable Rate. The Borrower may at any time convert a CFC Fixed Rate to the CFC Variable Rate by: (i) submitting a Conversion Request requesting that the CFC Variable Rate apply to any outstanding Advance; and (ii) paying to CFC promptly upon receipt of an invoice any applicable conversion fee calculated pursuant to CFC's long-term loan policies as established from time to time for similarly classified long-term loans. The effective date of the CFC Variable Rate shall be a date determined by CFC pursuant to its policies of general application following receipt of the Conversion Request.

C. A CFC Fixed Rate to Another CFC Fixed Rate. The Borrower may at its option at any time convert from a CFC Fixed Rate to another CFC Fixed Rate if the Borrower: (i) submits a Conversion Request requesting that a CFC Fixed Rate apply to any outstanding loan balance on an Advance and (ii) pays to CFC promptly upon receipt of an invoice any applicable conversion fee calculated pursuant to CFC's long-term loan policies as established from time to time for similarly classified long-term loans. The effective date of the new interest rate shall be a date determined by CFC pursuant to its policies of general application following receipt of the Conversion Request.

Section 3.4. Prepayment. The Borrower may at any time, on not less than thirty (30) days prior written notice to CFC, prepay any Advance, in whole or in part, together with the interest accrued to the date of prepayment and a prepayment premium, if any, as prescribed by CFC pursuant to its policies of general application in effect from time to time.

Section 3.5 Conversion to Amortizing Loan. If, on the Initial Maturity Date, (a) RUS has not approved, but has not yet declined, permanent financing for the Project, and (b) there is an outstanding balance on the Note, then such outstanding balance shall begin to amortize over a period not to exceed the Final Maturity Date. In such event, then the Borrower, upon receipt of an invoice relating to an amortizing Advance, shall promptly pay interest only on each Payment Date until the first Payment Date of the first full quarter following the Initial Maturity Date. Thereafter, quarterly or, at CFC's option, monthly installments of interest and/or principal in the amounts shown in the Payment Notice, shall be paid on each Payment Date; except that if not sooner paid, any amount due on account of the unpaid principal, interest accrued thereon and fees, if any, shall be due and payable on the Final Maturity Date. Advances shall amortize on a level debt service basis.

Section 3.6 Permanent Financing Commitment. The parties acknowledge that Advances hereunder are intended to permit the Borrower to begin construction or acquisition of the Project pending approval of the Borrower's application for RUS permanent financing for the Project. CFC hereby agrees that, in the event that RUS declines approval for such permanent financing, then CFC shall, if the Borrower so requests, provide such permanent financing for a term selected by the Borrower, but not to exceed the Final Maturity Date. In the event CFC provides such permanent financing, then the Borrower shall execute a new loan agreement, secured promissory note, security instrument, lien subordination agreement and such other documents, instruments and certificates as CFC may require in order to secure such permanent financing and perfect the lien created thereunder.

ARTICLE IV

CONDITIONS OF LENDING

Section 4. The obligation of CFC to make any Advance hereunder is subject to satisfaction of the following conditions:

A. Legal Matters. All legal matters incident to the consummation of the transactions hereby contemplated shall be satisfactory to counsel for CFC and, as to all matters of local law, to such local counsel as counsel for CFC may retain.

B. Documents. CFC shall have been furnished with executed copies, satisfactory to CFC, of this Agreement, and the Note and certified copies, satisfactory to CFC, of all such corporate documents and proceedings of the Borrower authorizing the transactions hereby contemplated as CFC shall require. CFC shall have received an opinion of counsel for the Borrower addressing such legal matters as CFC shall reasonably require.

C. Government Approvals. The Borrower shall have furnished to CFC true and correct copies of all certificates, authorizations and consents, including without limitation the consents referred to in Section 2.F. hereof, necessary for the execution, delivery or performance by the Borrower of this Agreement and the Note.

D. Representations and Warranties. The representations and warranties contained in Article II shall (except as affected by the transactions contemplated by this Agreement) be true on the date of the making of each Advance hereunder with the same effect as though such

representations and warranties had been made on such date; no Event of Default specified in Article VI and no event which, with the lapse of time or the notice and lapse of time specified in Article VI would become such an Event of Default, shall have occurred and be continuing or will have occurred after giving effect to the Advance on the books of the Borrower; there shall have occurred no material adverse change in the business or condition, financial or otherwise, of the Borrower; and nothing shall have occurred which in the opinion of CFC materially and adversely affects the Borrower's ability to meet its obligations hereunder.

E. Requisitions. The Borrower will requisition all Advances by submitting its written requisition to CFC in form and substance satisfactory to CFC. Requisitions shall be made only for the purpose as set forth herein. The Borrower agrees to apply the proceeds of the Advances in order to finance Project expenses.

F. Special Conditions. The Borrower shall have complied with any special conditions listed in Schedule 1 hereto.

G. Other Information. Borrower shall have furnished such other information as CFC may reasonably require, including but not limited to cash flow projections, financial analyses and pro forma financial statements sufficient to demonstrate to CFC's reasonable satisfaction that Borrower shall continue to achieve the DSC ratio set forth in Section 5.B. herein, to meet all of its debt service obligations, and otherwise to perform and to comply with all other covenants and conditions set forth in this Agreement.

H. Application to RUS for Permanent Financing. Borrower shall have made application to RUS for permanent financing of the Project.

I. Paying Agent Service. If requested by CFC, Borrower shall subscribe to CFC's Paying Agent Service and shall use the Paying Agent Service in order for CFC, as Borrower's agent, to transmit debt service payments to RUS on behalf of the Borrower on its RUS Loans, *provided, however*, that notwithstanding any term, condition or provision contain herein, no payment made to CFC through the Paying Agent Service or otherwise shall be considered a payment on any of the Borrower's RUS Loans unless and until RUS shall have actually received such payment. Borrower shall not be required to continue the Paying Agent Service in the event CFC provides permanent financing as contemplated by Section 3.6 hereof.

ARTICLE V

COVENANTS

Section 5. After the date hereof and until payment in full of the Note and performance of all obligations of the Borrower hereunder:

A. Membership. Borrower agrees that it will remain a member in good standing of CFC.

B. Financial Ratios; Design of Rates. The Borrower, subject to events in the judgment of CFC to be beyond the control of the Borrower, shall so operate and manage its business as to achieve a DSC of not less than 1.0, said DSC ratio being determined by averaging the two highest annual ratios during the most recent three calendar years. The Borrower shall

design its rates so that such ratio will be achieved. Without the prior written consent of CFC, the Borrower shall not decrease its rates for electric service if it has failed to achieve a DSC of 1.0 for the calendar year prior to such reduction subject only to an order from a regulatory body properly exercising jurisdiction over the Borrower.

C. Annual Certificate. Within one hundred-twenty (120) days after the close of each calendar year, commencing with the year following the year in which the initial Advance hereunder shall have been made, Borrower will deliver to CFC a written statement signed by its General Manager, stating that during such year, and that to the best of said person's knowledge, the Borrower has fulfilled all of its obligations under this Agreement and the Note throughout such year or, if there has been a default in the fulfillment of any such obligations, specifying each such default known to said person and the nature and status thereof.

D. Loan Capital Term Certificate Purchase. Borrower will purchase an LCTC, if required, in an amount calculated pursuant to CFC's policies of general application. The purchase price of the LCTC, if any, shall be calculated at the time of the initial Advance on a Note pursuant to CFC's policies as established from time to time for loans similarly classified. Such purchase shall be paid for on a *pro rata* basis with each Advance pursuant to CFC's policies. CFC agrees to deliver the LCTC within ninety (90) days following the date on which the LCTC has been paid for in full.

E. Notice of Change in Place of Business. Borrower will notify CFC promptly in writing of any change in location of its principal place of business or the office where its records concerning accounts and contract rights are kept.

F. Financial Books; Financial Reports; Right of Inspection. The Borrower will at all times keep, and safely preserve, proper books, records and accounts in which full and true entries will be made of all of the dealings, business and affairs of the Borrower, in accordance with generally accepted accounting principles. The Borrower will prepare and furnish CFC within forty-five (45) days of the close of each fiscal quarter of the Borrower, financial and statistical reports on its condition and operations for the previous fiscal quarter. When requested by CFC, the Borrower will prepare and furnish CFC from time to time, not later than the last day of each month, financial and statistical reports on its condition and operations for the previous month. All of such reports shall be in such form and include such information as may be specified by CFC, including without limitation an analysis of Borrower's revenues, expenses and consumer accounts. Within one hundred twenty (120) days of the end of each calendar year during the term hereof, Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such calendar year, in form and substance satisfactory to CFC. In addition, within one hundred twenty (120) days of the end of each Borrower's fiscal years during the term hereof, Borrower shall furnish to CFC a full and complete report of its financial condition and statement of its operations as of the end of such fiscal year, audited and certified by independent certified public accountants nationally recognized or otherwise satisfactory to CFC and accompanied by a report of such audit in form and substance satisfactory to CFC. CFC, through its representatives, shall at all times during reasonable business hours and upon prior notice have access to, and the right to inspect and make copies of, any or all books, records and accounts, and any or all invoices, contracts, leases, payrolls, canceled checks, statements and other documents and papers of every kind belonging to or in the possession of the Borrower or in anyway pertaining to its property or business.

G. Limitations on Mergers. The Borrower may consolidate with, merge, or sell all or substantially all of its business or assets, to another entity or person provided such action is either approved, as is evidenced by the prior written consent of CFC, or the purchaser, successor or resulting corporation remains a member in good standing of CFC and assumes the due and punctual payment of the Note and the due and punctual performance of the covenants contained in this Agreement.

H. Limitation on Dividends, Patronage Refunds and Other Distributions.

(a) The Borrower may make Distributions in any calendar year if, after giving effect to the Distribution, the total Equity of the Borrower will be at least thirty percent (30%) of its Total Assets.

(b) If, after giving effect to the Distribution, the total Equity of the Borrower will be less than thirty percent (30%) of its Total Assets, then the Borrower may nevertheless make Distributions of up to twenty-five percent (25%) of its total margins for the preceding calendar year.

(c) Notwithstanding anything to the contrary in subparagraphs (a) and (b) above, the Borrower shall not make any Distribution without the prior written consent of CFC if (i) a payment default or other Event of Default under this Agreement has occurred and is continuing, or (ii) after giving effect to the Distribution, the Borrower's total current and accrued assets would be less than its total current and accrued liabilities, or (iii) such Distribution would be in excess of the Distributions permitted by subparagraphs (a) or (b), above.

(d) For purposes of this paragraph H., the term "Distribution" means any dividend, patronage refund, patronage capital retirement or cash distribution to its members, stockholders or consumers (including but not limited to any general cancellation or abatement of charges for electric energy or services furnished by the Borrower).

I. Limitations on Loans, Investments and Other Obligations.

(a) The Borrower shall not, without first obtaining the written approval of CFC: (i) purchase or make any commitment to purchase any stock, bonds, notes, debentures, or other securities or obligations of or beneficial interests in, (ii) make any other investment in, (iii) make any loan to, or (iv) guarantee, assume, or otherwise become liable for any obligation of any corporation, association, partnership, joint venture, trust, government or any agency or department thereof, or any other entity of any kind if the aggregate amount of all such purchases, investments, loans and guarantees exceeds three percent (3%) of Total Utility Plant.

(b) The following shall not be included in the limitation of purchases, investments, loans and guarantees in (a) above: (i) bonds, notes, debentures, stock, or other securities or obligations issued by or guaranteed by the United States government or any agency or instrumentality thereof; (ii) bonds, notes, debentures, stock, commercial paper, subordinated capital certificates, or any other security or obligation of institutions whose senior unsecured debt obligations are rated by at least two nationally recognized rating organizations in either of its two highest categories; (iii) investments incidental to loans made by CFC; and (iv) any deposit that is fully insured by the Federal Government.

(c) In no event may the Borrower take any action pursuant to subsection (a) when there is: (i) unpaid any due installment of principal and/or interest on the Note; or (ii) Borrower has failed to meet the financial ratio tests in Section 5.B. herein.

J. Change of Name. Borrower will notify CFC promptly in writing of any change to the name of Borrower.

K. Special Affirmative Covenants. Borrower will comply with any and all special affirmative covenants as listed in Schedule 1 hereto.

L. Funds Requisition. Borrower agrees (a) that CFC may rely conclusively upon the interest rate option, interest rate term and other written instructions submitted to CFC in Borrower's written request for an Advance hereunder, (b) that such instructions shall constitute a covenant under this Agreement to repay the Advance in accordance with such instructions, the Note and this Agreement, (c) to request Advances only for the purposes set forth herein, and (d) to use the proceeds thereof only in accordance with the terms hereof.

M. Application of Payments; Accounting. The Borrower hereby agrees and irrevocably instructs CFC that any payments made through the Paying Agent Service shall be applied as follows: first, to all amounts due hereunder (including without limitation interest, principal and any charges or fees provided for herein, whether by acceleration or otherwise); second, to all amounts due on RUS Loans and, if applicable, to CFC and any other lenders *pari passu* on any secured loans which have been made to the Borrower by CFC or another lender and secured by a mortgage or other security instrument (including without limitation interest, principal and any charges or fees, whether by acceleration or otherwise); and third, to any other payee as the Borrower may direct.

N. Prepayment of RUS Loans. Borrower shall not prepay any RUS Loan without CFC's prior written consent.

ARTICLE VI

EVENTS OF DEFAULT

Section 6. The following shall be Events of Default under this Agreement:

A. Representations and Warranties. Any representation or warranty made by the Borrower herein in any certificate or financial statement furnished to CFC hereunder which shall prove to be false or misleading in any material respect.

B. Payment. Default shall be made in the payment of or on account of interest on or principal of (or premium, if any, associated with) the Note when and as the same shall be due and payable, whether by acceleration or otherwise, which shall remain unsatisfied for five (5) Business Days;

C. Other Covenants. Default by the Borrower in the observance or performance of any other covenant or agreement contained in this Agreement or in the Note, which shall remain unremedied for thirty (30) calendar days after written notice thereof shall have been given to the Borrower by CFC;

D. Corporate Existence. The Borrower shall forfeit or otherwise be deprived of its corporate charter, franchises, permits, easements, consents or licenses required to carry on any material portion of its business;

E. Other Obligations. Default by the Borrower in the payment of any obligation, whether direct or contingent, for borrowed money or in the performance or observance of the terms of any instrument pursuant to which such obligation was created or securing such obligation;

F. Bankruptcy. The Borrower shall file a petition in bankruptcy or be adjudicated bankrupt or insolvent, or shall make an assignment for the benefit of its creditors, or shall consent to the appointment of a receiver of itself or of its property, or shall institute proceedings for its reorganization, or proceedings instituted by other for its reorganization, shall not be dismissed within sixty (60) days after the institution thereof.

G. Dissolution or Liquidation. Other than as provided in subsection F. above, the dissolution or liquidation of the Borrower, or failure by the Borrower promptly to forestall or remove any execution, garnishment or attachment of such consequence as will impair its ability to continue its business or fulfill its obligations and such execution, garnishment or attachment shall not be vacated within sixty (60) days. The term "dissolution or liquidation of the Borrower", as used in this subsection, shall not be construed to include the cessation of the corporate existence of the Borrower resulting either from a merger or consolidation of the Borrower into or with another corporation following a transfer of all or substantially all its assets as an entirety, under the conditions permitting such actions.

H. Final Judgment. A final judgment in excess of \$100,000 shall be entered against the Borrower and shall remain unsatisfied or without a stay for a period of sixty (60) days.

ARTICLE VII

REMEDIES

Section 7.01 General Remedies. If any of the Events of Default listed in Section 6 hereof shall occur after the date of this Agreement and shall not have been remedied, then CFC may declare all amounts due on account of this Agreement or the Note to be immediately due and payable and may pursue all other rights and remedies available to CFC that are contemplated by this Agreement in the manner, upon the conditions, and with the effect provided in this Agreement, including but not limited to, a suit for specific performance, injunctive relief or damages. Nothing herein shall limit the right of CFC to pursue all rights and remedies available to a creditor following the occurrence of an Event of Default listed in Section 6 hereof. Each right, power and remedy of CFC shall be cumulative and concurrent, and recourse to one or more rights or remedies shall not constitute a waiver of any other right, power or remedy.

Section 7.02 RUS Subrogation Rights. In the event that there is an Event of Default hereunder and RUS pays to CFC in full all amounts due hereunder, then RUS shall be subrogated to all of CFC's rights under this Agreement, including any legal or equitable lien priority created on any of the Borrower's property.

ARTICLE VIII

MISCELLANEOUS

Section 8.1. Notices. All notices, requests and other communications provided for herein including, without limitation, any modifications of, or waivers, requests or consents under, this Agreement shall be given or made in writing (including, without limitation, by telecopy) and delivered to the intended recipient at the "Address for Notices" specified below; or, as to any party, at such other address as shall be designated by such party in a notice to each other party. Except as otherwise provided in this Agreement, all such communications shall be deemed to have been duly given when personally delivered or, in the case of a telecopied or mailed notice, upon receipt, in each case given or addressed as provided for herein. The Addresses for Notices of the respective parties are as follows:

National Rural Utilities Cooperative Finance Corporation
2201 Cooperative Way
Herndon, Virginia 20171
Fax: (703) 709-6776

Attention: Senior Vice President, Member Services

The Borrower:

The address set forth in Schedule 1 hereto

Section 8.2. Expenses. The Borrower will pay all costs and expenses of CFC, including reasonable fees of counsel, incurred in connection with the enforcement of this Agreement and the Note and the other instruments provided for herein or with the preparation for such enforcement if CFC has reasonable grounds to believe that such enforcement may be necessary.

Section 8.3. Late Payments. If payment of any amount due hereunder is not received at CFC's office in Herndon, Virginia, or such other location as CFC may designate to the Borrower within five (5) Business Days after the due date thereof (such unpaid amount being herein called the "delinquent amount", and the period beginning after such due date until payment of the delinquent amount being herein called the "late-payment period"), the Borrower will pay to CFC, in addition to all other amounts due under the terms of the Note and this Agreement, any late-payment charge as may be fixed by CFC from time to time on the delinquent amount for the late-payment period.

Section 8.4. No Waiver. No failure on the part of CFC to exercise, and no delay in exercising, any right under this Agreement or the Note shall operate as a waiver thereof nor shall any single or partial exercise by CFC of any right under this Agreement or the Note preclude any other or further exercise thereof or the exercise of any other right. No waiver of any provision of this Agreement or the Note and no consent to any departure by Borrower therefrom shall in any event be effective unless the same shall be in writing by the party granting such waiver or consent.

SECTION 8.5. GOVERNING LAW; SUBMISSION TO JURISDICTION; WAIVER OF JURY TRIAL.

(a) THE PERFORMANCE AND CONSTRUCTION OF THIS AGREEMENT AND THE NOTE SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE COMMONWEALTH OF VIRGINIA.

(b) BORROWER HEREBY SUBMIT(S) TO THE NONEXCLUSIVE JURISDICTION OF THE UNITED STATES COURTS LOCATED IN VIRGINIA AND OF ANY STATE COURT SO LOCATED FOR PURPOSES OF ALL LEGAL PROCEEDINGS ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY. BORROWER IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY OBJECTION THAT IT MAY NOW OR HEREAFTER HAVE TO THE ESTABLISHING OF THE VENUE OF ANY SUCH PROCEEDING BROUGHT IN SUCH A COURT AND ANY CLAIM THAT ANY SUCH PROCEEDING HAS BEEN BROUGHT IN AN INCONVENIENT FORUM.

(c) EACH OF THE BORROWER AND CFC HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

Section 8.6. Holiday Payments. If any payment to be made by the Borrower hereunder shall become due on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and such extension of time shall be included in computing any interest in respect of such payment.

Section 8.7. Termination of Commitment. On the date that is one (1) year from the date hereof, CFC may stop advancing funds and limit the CFC Commitment to the amount advanced prior to such date.

Section 8.8. Amendments. No amendment of any provision of this Agreement or the Note shall in any event be effective unless the same shall be in writing and signed by both CFC and the Borrower.

Section 8.9. Merger and Integration. This Agreement and the attached exhibits and matters incorporated by reference contain the entire agreement of the parties hereto with respect to the matters covered and the transactions contemplated hereby.

Section 8.10. Headings. The headings and sub-headings contained in the titling of this Agreement are intended to be used for convenience only and do not constitute part of this Agreement.

Section 8.11. Severability. If any term, provision or condition, or any part thereof, of this Agreement or the Note shall for any reason be found or held invalid or unenforceable by any governmental agency or court of competent jurisdiction, such invalidity or unenforceability shall not affect the remainder of such term, provision or condition nor any other term, provision or

condition, and this Agreement and the Note shall survive and be construed as if such invalid or unenforceable term, provision or condition had not been contained therein.

Section 8.12. Right of Setoff. Upon the occurrence and during the continuance of any Event of Default, CFC is hereby authorized at any time and from time to time, without prior notice to the Borrower, to exercise rights of setoff or recoupment and apply any and all amounts held, or hereafter held, by CFC or owed to the Borrower or for the credit or account of the Borrower against any and all of the obligations of the Borrower now or hereafter existing hereunder or under the Note, *provided, however*, that CFC shall not exercise its setoff rights against any amounts held by it as agent for the Borrower pursuant to the Paying Agent Service. CFC agrees to notify the Borrower promptly after any such setoff or recoupment and the application thereof, provided that the failure to give such notice shall not affect the validity of such setoff, recoupment or application. The rights of CFC under this section are in addition to any other rights and remedies (including other rights of setoff or recoupment) which CFC may have. Borrower waives all rights of setoff, deduction, recoupment or counterclaim.

Section 8.14. Schedule 1. Schedule 1 attached hereto is an integral part of this Agreement and is incorporated by reference herein.

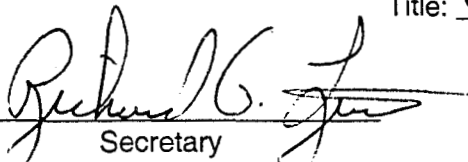
IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the day and year first above written.

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

(SEAL)

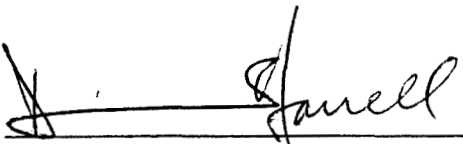
By: 

Title: Chief Financial Officer

Attest: 
Secretary

NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORPORATION

(SEAL)

By: 
Assistant Secretary-Treasurer
DAVID FARRELL

Attest: 
Assistant Secretary-Treasurer

RECEIVED 1988

SCHEDULE 1

1. The CFC Commitment is \$24,500,000.00.
2. The Project consists of a General Electric LM 6000 gas turbine generator with peaking power capacity of 40 MW, to be located at the Apache Station Facility in Cochise, Arizona.
3. The date of this Borrower's balance sheet referred to in Section 2.D. is December 31, 2000.
4. The principal place of business of the Borrower referred to in Section 2.E. and Section 8.1 is 1000 South Highway 80, Benson, Arizona 85602.
5. The governmental authority referred to in Section 2.F. is the Arizona Corporation Commission.
6. The months relating to the Payment Date referred to in Section 3.2.A are March, June, September and December.
7. The special conditions referred to in Section 4.F. are: None.
8. The special affirmative covenants referred to in Section 5.K. are: None.

INTERCREDITOR AGREEMENT

dated as of December 12, 2001

between the

UNITED STATES OF AMERICA
acting through the Administrator of the
Rural Utilities Service

and

NATIONAL RURAL UTILITIES COOPERATIVE
FINANCE CORPORATION

With respect to financing for

Apache Station Facility, Cochise, AZ

INTERCREDITOR AGREEMENT dated as of _____,
between the UNITED STATES OF AMERICA, acting through the Administrator of the Rural
Utilities Service; and NATIONAL RURAL UTILITIES COOPERATIVE FINANCE
CORPORATION, a cooperative association existing under the laws of the District of Columbia.

RECITALS

1. The Government, through a program administered by RUS, from time to time provides long-term financing to power supply cooperative borrowers for the acquisition and construction of electric generation and transmission facilities pursuant to the Rural Electrification Act of 1936, as amended (7 U.S.C. §901 et seq.).

2. RUS and CFC wish to establish an agreement between them with the objective of expediting availability of loan funds to the Cooperative in order to enable the Cooperative to begin the acquisition and construction of combustion turbine generating facilities during the period in which Cooperative's application to the Government for long-term financing of the Project is pending approval.

3. CFC is willing to enter into certain loan agreements with the Cooperative, and pursuant thereto, make interim loans to a Cooperative for purposes of Facilities Financing subject to the terms, conditions and provisions contained herein and in said loan agreements.

4. RUS has made a preliminary determination that the Cooperative is eligible to receive financial assistance under the terms of the Act and that the Project appears to be financially feasible and is willing to process the Borrower's application for permanent financing.

NOW, THEREFORE, in consideration of the mutual agreements herein contained RUS and CFC agree as follows:

ARTICLE 1

DEFINITIONS

SECTION 1.1 Definitions. As used in this Agreement (including the foregoing Recitals), the following terms shall have the following meanings:

"Act" shall mean the Rural Electrification Act of 1936, as amended (7 U.S.C. § 901 et seq.).

"Agreement" shall mean this Intercreditor Agreement, as the same may be amended, supplemented, consolidated or restated from time to time.

"Business Day" shall mean any day other than a Saturday, a Sunday, a legal public holiday under 5 U.S.C. §6103 for the purpose of statutes relating to pay and leave of employees or any other day declared to be a legal holiday for the purpose of statutes relating to pay and leave of employees by Federal statute or Federal Executive Order.

"CFC" shall mean National Rural Utilities Cooperative Finance Corporation.

"Cooperative" shall mean Arizona Electric Power Cooperative, Inc.

"Facilities Financing" shall mean a Project Loan or an RUS Loan made to a Cooperative solely for purposes of acquisition and construction of the Project and also including any ancillary costs associated therewith as may be agreed between the Cooperative, CFC and RUS.

"Government" shall mean the United States of America.

"Lender" shall mean CFC.

"Mortgage" shall mean (i) any mortgage or security agreement (however styled or titled) entered into between the Government and the Cooperative which grants a security interest in substantially all of a Cooperative's real property, personal property and fixtures, or (ii) any mortgage or security agreement (however styled or titled) entered into between the Government, CFC and the Cooperative which grants a security interest in substantially all of the Cooperative's real property, personal property and fixtures, or (iii) any indenture of trust entered into between the Cooperative and a trustee for the benefit of the holders of obligations secured thereunder, which holders include the Government and/or CFC, and (iv) any amendments, supplements or restatements of any of the foregoing.

"Paying Agent Service" shall mean the service offered by Lender whereby Lender, as agent for the Cooperative, undertakes to make debt service and other payments on behalf of and as directed by the Cooperative.

"Project" shall mean the combustion turbine generating project described on exhibit one which is attached hereto as if fully set forth at this point.

"Project Loan" shall mean a loan made by CFC to the Cooperative for purposes of Facilities Financing.

"Project Loan Agreement" shall mean a loan agreement entered into between CFC and the Cooperative setting forth the terms, conditions and provisions of the Project Loan.

"RUS" shall mean the Rural Utilities Service, an agency of the United States Department of Agriculture.

"RUS Loans" shall mean loans made by RUS to the Cooperative, or made to the Cooperative by a third party and guaranteed as to payment by RUS, in each instance for such purposes as are authorized in the Act.

"RUS Loan Agreement" shall mean collectively the loan agreements entered into between RUS and the Cooperative setting forth the terms, conditions and provisions of RUS Loans.

SECTION 1.2 Rules of Construction. Unless the context shall otherwise indicate, the terms defined in Section 1.1 hereof include the plural as well as the singular and the singular as well as the plural. The words "herein", "hereof", "hereto" and "hereunder", and words of similar import, refer to this Agreement as a whole. The word "person" includes corporations, associations and public bodies, as well as natural persons. The foregoing Recitals are incorporated herein and made a part of this Agreement.

ARTICLE 2

LENDER LOAN

SECTION 2.1 Project Loan. From time to time, the Lender may make loans to the Cooperative to finance the acquisition and construction of the Project upon the terms and subject to satisfaction of the conditions of the Project Loan Agreement, which shall be determined by the Lender. Nothing in this Agreement, however, shall be deemed to require or commit Lender to making a loan to the Cooperative. No loan made by CFC, other than a Project Loan for the Project, and no loan agreement, other than a Project Loan Agreement for the Project, shall contain or be subject to the payment subordination and lien subordination provisions set forth in this Agreement. A Project Loan Agreement shall not contain any term, condition or provision which purports to alter the terms of an RUS Loan Agreement.

SECTION 2.2 Paying Agent Service. Lender may, at its option, require a Cooperative to subscribe to Lender's Paying Agent Service and to use the Paying Agent Service in order for CFC, as the Cooperative's agent, to make debt service payments to the Government for all of the Cooperative's indebtedness on RUS Loans. Each Project Loan Agreement shall contain an agreement and acknowledgment by the Cooperative that, notwithstanding any term, condition or provision contained therein, no payment made to CFC through the Paying Agent Service or otherwise shall be considered a payment to the Government on RUS Loans unless and until the Government shall have actually received such payment.

SECTION 2.3 Application of Payments; Accounting. The Project Loan Agreement for the Project shall contain an agreement and irrevocable instruction by the Cooperative that any payments made to CFC through the Paying Agent Service shall be applied as follows: first, to all Project related amounts due on the Project Loan under the terms of the Project Loan Agreement (including without limitation interest, principal and any charges or fees provided for in the Project Loan Agreement, whether by acceleration or otherwise); second, to all amounts due the Government on the RUS Loans under the terms of the RUS Loan Agreements and, if applicable, to CFC and other secured lenders *pari passu* on any loans other than Project Loans which have been made to the Borrower by CFC or another lender and secured by a Mortgage (including without limitation interest, principal and any charges or fees provided for in the RUS Loan Agreements and any such other loan agreements between the Cooperative and CFC or another lender, whether by acceleration or otherwise); and third, to any other payee as the Cooperative may direct. CFC shall provide RUS with an accounting with respect to the application of each payment received from a Cooperative through the Paying Agent Service.

ARTICLE 3

LOAN SECURITY AND SUBORDINATION PROVISIONS

SECTION 3.1 Payment Subordination. The Government hereby consents and agrees as follows:

(a) the obligation of the Cooperative to make payments on the RUS Loans shall be and the same is hereby made subject and subordinate to the obligation of the Cooperative to make payments on the Project Loan;

(b) the rights of the Government to collect from the Cooperative all amounts due on the RUS Loans pursuant to the RUS Loan Agreements shall be and the same are hereby made subject and subordinate to the rights of CFC to collect from the Cooperative all amounts due on the Project Loan pursuant to the Project Loan Agreement; and

(c) subject to Section 3.5 hereof, the rights of the Government to enforce the Cooperative's payment obligations to the Government on RUS Loans pursuant to the RUS Loan Agreements shall be and the same are hereby made subject and subordinate to the rights of CFC to enforce the Cooperative's payment obligations to CFC on the Project Loan pursuant to the Project Loan Agreement; and

(d) any and all funds received by CFC from a Cooperative through the Paying Agent Service or otherwise for purposes of making payments to RUS on the RUS Loans shall be applied in the manner set forth in Section 2.3 hereof.

SECTION 3.2 Further Agreements With Respect to Payment Subordination.

(a) To the extent that, by law or under the RUS Loan Agreements, the Government has rights to assert or claim a lien upon any cash (i) held by the Cooperative, (ii) held by a third party and owed to the Cooperative, or (iii) held by a third party for the benefit of the Cooperative, the Government hereby agrees that the operation and effect of this Agreement and all of the terms, provisions, rights and privileges contained herein which grant to CFC a right to payment priority on the Project Loan, are superior to said rights of the Government.

(b) In the event that the Government receives any payments from a Cooperative on an RUS Loan while there is due and unpaid any payment on a Project Loan, then CFC shall be entitled to enforce the provisions of this Agreement through any legal proceeding in order to recover such payments from the Government.

(c) The provisions of Section 3.1 and 3.2 hereof shall terminate and be of no further force and effect automatically and without further action by either CFC or RUS upon the first date that the documentation to record subordination of the Government's lien, referred to in Section 3.3(b) hereof, is recorded in order to perfect CFC's priority security interest referred to in Section 3.3.

SECTION 3.3 Lien Subordination.

(a) The Government hereby consents and agrees that the lien created under a Mortgage to secure all of the Cooperative's outstanding indebtedness to the Government shall

be subject and subordinate to the lien of CFC created under a Mortgage entered into for purposes of securing the Cooperative's outstanding indebtedness to CFC under the Project Loan. Nothing herein shall be deemed or construed as consenting to subordination of the Government's lien to secure any indebtedness of the Cooperative to CFC other than the indebtedness created by the Project Loan and the related Project Loan Agreement.

(b) The Government and CFC shall cooperate in good faith to develop, agree upon and execute such instruments and documents as may be necessary or appropriate in order to document, in recordable form, the lien subordination provided for in Section 3.3(a). CFC shall be entitled, at its option, to record and file such instruments and documents (including any amendments, supplements and restatements thereof) at any time and from time to time, in all locations deemed necessary by CFC to perfect and maintain its priority security interest as provided for herein, until the Cooperative has paid in full all amounts due under the Project Loan and the related Project Loan Agreement.

SECTION 3.4 Financing Statements; Contract Assignment. Prior to or after funding of a Project Loan, CFC shall be entitled to file appropriate UCC financing statements against the personal property of the Cooperative, but only with respect to such property as CFC has financed with Project Loan. CFC shall also be entitled to require the Cooperative to assign for security purposes all construction contracts, power purchase agreements and other contracts (if any) inuring to the benefit of the Cooperative with respect to the Project.

SECTION 3.5 Exercise of Remedies. Nothing herein shall be deemed or construed to grant CFC rights to exercise any remedies under a Mortgage, and CFC shall not exercise any such right, unless and until such Mortgage is recorded and CFC is a secured creditor thereunder.

SECTION 3.6 Foreclosure by RUS; Subrogation. Without the prior written consent of CFC, RUS shall not initiate proceedings to foreclose on all or any part of the Government's Mortgage lien while there is an outstanding balance on the Project Loan; provided, however, that if RUS shall first pay the Project Loan to CFC in full, RUS may then exercise any foreclosure remedy otherwise available to it. Such payment to CFC will be deemed an expense of foreclosure and added to the Cooperative's aggregate indebtedness to RUS as an enforcement expense. In such event, and provided CFC is paid in full on its Project Loan, then RUS shall be subrogated to all of CFC's rights under the Project Loan Agreement, including any legal or equitable lien priority created on any of the Cooperative's property. CFC shall require a Cooperative to acknowledge and accept this contingent subrogation in any Project Loan Agreement with the Cooperative.

SECTION 3.7 Permanent Financing Contingency. In the event that CFC makes a Project Loan as provided for in this Agreement, then CFC and RUS further agree as follows:

(a) such Project Loan shall have an initial term of up to four (4) years;

(b) as a condition precedent to obtaining a Project Loan, the Cooperative shall be required to apply for an RUS Loan for purposes of obtaining permanent financing of such Project Loan;

be subject and subordinate to the lien of CFC created under a Mortgage entered into for purposes of securing the Cooperative's outstanding indebtedness to CFC under the Project Loan. Nothing herein shall be deemed or construed as consenting to subordination of the Government's lien to secure any indebtedness of the Cooperative to CFC other than the indebtedness created by the Project Loan and the related Project Loan Agreement.

(b) The Government and CFC shall cooperate in good faith to develop, agree upon and execute such instruments and documents as may be necessary or appropriate in order to document, in recordable form, the lien subordination provided for in Section 3.3(a). CFC shall be entitled, at its option, to record and file such instruments and documents (including any amendments, supplements and restatements thereof) at any time and from time to time, in all locations deemed necessary by CFC to perfect and maintain its priority security interest as provided for herein, until the Cooperative has paid in full all amounts due under the Project Loan and the related Project Loan Agreement.

SECTION 3.4 Financing Statements; Contract Assignment. Prior to or after funding of a Project Loan, CFC shall be entitled to file appropriate UCC financing statements against the personal property of the Cooperative, but only with respect to such property as CFC has financed with Project Loan. CFC shall also be entitled to require the Cooperative to assign for security purposes all construction contracts, power purchase agreements and other contracts (if any) inuring to the benefit of the Cooperative with respect to the Project.

SECTION 3.5 Exercise of Remedies. Nothing herein shall be deemed or construed to grant CFC rights to exercise any remedies under a Mortgage, and CFC shall not exercise any such right, unless and until such Mortgage is recorded and CFC is a secured creditor thereunder.

SECTION 3.6 Foreclosure by RUS; Subrogation. Without the prior written consent of CFC, RUS shall not initiate proceedings to foreclose on all or any part of the Government's Mortgage lien while there is an outstanding balance on the Project Loan; provided, however, that if RUS shall first pay the Project Loan to CFC in full, RUS may then exercise any foreclosure remedy otherwise available to it. Such payment to CFC will be deemed an expense of foreclosure and added to the Cooperative's aggregate indebtedness to RUS as an enforcement expense. In such event, and provided CFC is paid in full on its Project Loan, then RUS shall be subrogated to all of CFC's rights under the Project Loan Agreement, including any legal or equitable lien priority created on any of the Cooperative's property. CFC shall require a Cooperative to acknowledge and accept this contingent subrogation in any Project Loan Agreement with the Cooperative.

SECTION 3.7 Permanent Financing Contingency. In the event that CFC makes a Project Loan as provided for in this Agreement, then CFC and RUS further agree as follows:

- (a) such Project Loan shall have an initial term of up to four (4) years;
- (b) as a condition precedent to obtaining a Project Loan, the Cooperative shall be required to apply for an RUS Loan for purposes of obtaining permanent financing of such Project Loan;

(c) in the event that, for any reason, the Government does not approve and fund such permanent financing, then CFC shall provide said permanent financing up to a term of twenty (20) years;

(d) in the event CFC provides the permanent financing referenced in Section 3.7 (c) hereof, then CFC shall exercise its lien subordination option to perfect its security interest as set forth in Section 3.3 hereof;

(e) in the event that the Government provides permanent financing, and provided that the Project Loan for the Project shall be paid in full, then the Government may enter into any agreements with the Cooperative for the structure and terms or such permanent financing, including but not limited to arrangements for sale of the Project or transfer of the Project to a separate entity; and

(f) nothing in this Agreement shall be deemed to require or commit the Government to making a loan to the Cooperative.

SECTION 3.8 Change of Laws, Regulations or Policies. The Government reserves the right to adopt and amend laws, regulations and policies at its discretion and without regard to whether or not such action interferes with the performance of this Agreement by any party or makes it impracticable for any party to this Agreement to perform. The Lender hereby accepts the risk described in the preceding sentence; provided, however, that any subordination or other agreement that has been executed and delivered to the Lender by RUS pursuant to Article 3 of this Agreement shall not be subject to this reservation. The Lender acknowledges that the authority of RUS to issue new loans and guarantees is periodically affected by the Government's budget and appropriation process. The Lender hereby accepts the risk that in the future such authority to issue new loans and guarantees may be terminated, restricted, allowed to lapse, or used for other purposes by the Government.

SECTION 3.9 Eligibility and Feasibility. By their execution and delivery of this Agreement, RUS and CFC represent that they have each determined as of the date hereof that they have each independently satisfied themselves that the Project is feasible and that the Borrower qualifies for financial assistance from each of them, respectively, for the Project.

ARTICLE 4

REPRESENTATIONS OF THE PARTIES

SECTION 4.1 Representations of RUS. Subject always to the reservations contained in Section 3.8 hereof, RUS represents to CFC as follows:

(a) RUS has the power and authority to enter into this Agreement and the documents executed or to be executed by RUS pursuant hereto, and to perform all acts required to be performed by RUS hereunder and thereunder;

(b) The execution and delivery of this Agreement and the documents executed or to be executed by RUS pursuant hereto by RUS and the performance by RUS of all the acts required to be performed by RUS hereunder and thereunder have been duly authorized by all necessary action on the part of RUS; and

(c) This Agreement is a legal, valid and binding agreement of RUS.

SECTION 4.2 Representations of CFC. CFC hereby represents to RUS as follows:

(a) CFC has the power and authority to enter into this Agreement and the documents executed or to be executed by CFC pursuant hereto, and to perform all acts required to be performed by CFC hereunder and thereunder;

(b) The execution and delivery of this Agreement and the documents executed or to be executed by CFC pursuant hereto by CFC and the performance by CFC of all the acts required to be performed by CFC hereunder and thereunder have been duly authorized by all necessary action on the part of CFC; and

(c) This Agreement is a legal, valid and binding agreement of CFC.

ARTICLE 5

MISCELLANEOUS

SECTION 5.1 No Other Financing Restrictions. Nothing in this Agreement shall be deemed or construed to prohibit the Government or CFC from providing any additional financing to a Cooperative or from amending the terms, conditions or provisions of any other financing arrangements between the Cooperative and the Government or CFC, as the case may be.

SECTION 5.2 No Assumption of CFC Debt. Nothing in this Agreement shall be deemed or construed to mean that the Government has in any way assumed a Cooperative's debt to CFC or otherwise guaranteed payment of such debt.

SECTION 5.3 Waivers; Amendments.

(a) No failure or delay of RUS or the Lender in exercising any power or right hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such right or power, or any abandonment or discontinuance of steps to enforce such a right or power, preclude any other or further exercise thereof or the exercise of any other right or power.

(b) No provision of this Agreement may be waived, amended, or modified except pursuant to an agreement in writing entered into by RUS and the Lender.

SECTION 5.4 Notices. All communications and notices under this Agreement shall be communicated in writing or by telecommunications device capable of creating a written record, and any notice shall become effective (a) upon personal delivery thereof, including, without limitation, by overnight mail or courier service, (b) in the case of notice by United States mail, certified or registered, postage prepaid, return receipt requested, upon receipt thereof, or (c) in the case of notice by such a telecommunications device, upon transmission thereof, provided such transmission is promptly confirmed by either of the methods set forth in clauses (a) or (b) above, to the appropriate addresses set forth below, or at such other address as any party may designate by notice to the other parties hereto in accordance with this Section 5.4:

If to the Lender:

National Rural Utilities Cooperative Finance Corporation
2201 Cooperative Way
Herndon, VA 20171-3025
Attention: Senior Vice President, Member Services

If to RUS:

Rural Utilities Service
United States Department of Agriculture
1400 Independence Avenue, S.W.
Washington, D.C. 20250-1500
Attention: Administrator

SECTION 5.5 Entire Agreement. This Agreement constitutes the entire agreement among the parties hereto concerning the matters contained herein and supersedes all prior oral and written agreements and understandings among the parties.

SECTION 5.6 Headings. The descriptive headings of the various articles and sections of this Agreement were formulated and inserted for convenience only and shall not be deemed to affect the meaning or construction of the provisions hereof.

SECTION 5.7 Severability. If any term or provision of this Agreement or the application thereof to any circumstance shall, in any jurisdiction and to any extent, be invalid or unenforceable, such term or such provision shall be ineffective as to such jurisdiction to the extent of such invalidity or unenforceability without invalidating or rendering unenforceable any remaining terms or provisions of this Agreement or the application of such term or provision to circumstances other than those as to which it is held invalid or unenforceable.

SECTION 5.8 Term. This Agreement shall terminate and be of no further force and effect upon the occurrence of the earlier of (i) the provision of permanent financing, either by CFC as contemplated by Section 3.7(c) or the Government as contemplated by Section 3.7(e), or (ii) if CFC has not made a Project Loan hereunder, upon the fourth anniversary of the date of this Agreement.

SECTION 5.9 Survival. The representations of each of the parties hereto contained herein shall survive and shall continue in effect following the execution and delivery of this Agreement.

SECTION 5.10 GOVERNING LAW. THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH, THE LAWS OF THE UNITED STATES OF AMERICA, TO THE EXTENT APPLICABLE, AND OTHERWISE THE LAWS OF THE COMMONWEALTH OF VIRGINIA.

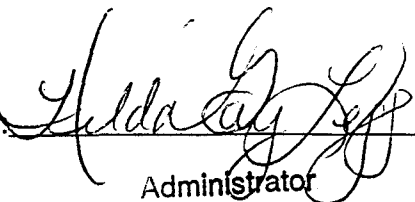
SECTION 5.11 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be an original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, each party hereto has caused this Agreement to be executed by an authorized officer as of the day and year first above written.

NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORPORATION

By: 
Assistant Secretary-Treasurer
DAVID FARRELL

UNITED STATES OF AMERICA
acting through the Administrator of the Rural
Utilities Service

By: 
Administrator
Title: _____

The undersigned Cooperative hereby accepts the foregoing agreement between CFC and the Government, and further acknowledges the payment priority, lien subordination and subrogation provisions contained therein.

Arizona Electric Power Cooperative, Inc.

By: _____

Title: _____

Date: _____

IN WITNESS WHEREOF, each party hereto has caused this Agreement to be executed by an authorized officer as of the day and year first above written.

NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORPORATION

By: 
Assistant Secretary-Treasurer
DAVID FARRELL

UNITED STATES OF AMERICA
acting through the Administrator of the Rural
Utilities Service

By: _____

Title: _____

The undersigned Cooperative hereby accepts the foregoing agreement between CFC and the Government, and further acknowledges the payment priority, lien subordination and subrogation provisions contained therein.

Arizona Electric Power Cooperative, Inc.

By: 

Title: Chief Financial Officer

Date: December 5, 2001

EXHIBIT 1

PROJECT DESCRIPTION

The Project will be comprised of the following facility:

Apache Station Facility, Cochise, Arizona: A General Electric LM 6000 gas turbine generator with peaking power capacity of 40 MW, projected to be commercial in late 2002.

Total estimated project cost is \$30,000,000.00.

PROMISSORY NOTE

\$24,500,000.00

December 12, 2001

ARIZONA ELECTRIC POWER COOPERATIVE, INC., an Arizona cooperative corporation ("Borrower"), for value received promises to pay, without setoff, deduction, recoupment or counterclaim, to the order of NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION ("Payee") at the Payee's main office or such other place as designated by the Payee, in lawful money of the United States, the sum of the aggregate unpaid principal amount of all Advances (as defined in the Loan Agreement referred to herein) made by the Payee, pursuant to a Loan Agreement dated as of even date herewith between the Borrower and the Payee, as may be amended from time to time (the "Loan Agreement"), with interest thereon in like money from the respective dates of each Advance hereunder, at the rate or rates and payable at the times provided in said Loan Agreement together with any other amount payable under the Loan Agreement, all on the date that is four (4) years from the date of the initial Advance hereunder (such date being the Initial Maturity Date hereof), *provided, however*, that if Advances hereunder are converting to amortizing Advances pursuant to Section 3.5 of the Loan Agreement, then the sum of aggregate unpaid principal amount of all Advances made by the Payee pursuant to the Loan Agreement shall be paid on the date that is twenty (20) years from the date hereof (such date being the Final Maturity Date hereof), *provided, however*, that if either the Initial Maturity Date or the Final Maturity Date, as applicable, is not a Payment Date (as defined in the Loan Agreement), then, in either case, such date shall be the Payment Date immediately preceding such date,

This Note is the Note referred to in, and has been executed and delivered pursuant to, the Loan Agreement.

The principal hereof and interest accrued thereon and any other amount due under the Loan Agreement may be declared to be forthwith due and payable in the manner, upon the conditions, and with the effect provided in the Loan Agreement.

The Borrower waives demand, presentment for payment, notice of dishonor, protest, notice of protest, and notice of non-payment of this Note.

IN WITNESS WHEREOF the Borrower has caused this Note to be signed in its corporate name and its corporate seal to be hereunto affixed and to be attested by its duly authorized officers, all as of the day and year first above written.

(SEAL)

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

By: 

Title: Chief Financial Officer

Attest: 

Secretary

Loan No. AZ 028-A-9028